No. 20,110

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

JAMES H. MARSHALL and THELMA MARSHALL,

Appellees.

ON APPEAL FROM THE JUDGMENT OF
THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

BRIEF FOR THE APPELLEE

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OPINION OF THE DISTRICT COURT

The opinion of the District Court (R. 43-47) by James M. Carter, Judge, is reported at 241 F. Supp. 30.

JURISDICTION

On July 19, 1963, James H. Marshall and Thelma Marshall filed a complaint in the U. S. District Court for the Southern District of California, seeking refund of a portion of the federal income tax paid for 1959. The District Court had jurisdiction pursuant to 28 U. S. C., Sections 1340 and 1346(a)(1). The case was submitted on pre-trial stipulation of facts (R. 10-13) and written briefs (R. 14-42).

The taxpayers prevailed in a memorandum decision filed September 30, 1964 (R. 43-47). Judgment (R. 53) and findings of fact and conclusions of law (R. 48-52) were filed on January 26, 1965. Notice of appeal was filed by the United States on March 29, 1965 (R. 55). This court has jurisdiction to review the decision of the District Court pursuant to 28 U.S.C., Section 1291.

QUESTION INVOLVED

Whether the District Court erred in holding that the taxpayers properly treated the sale of their business as an installment sale, for the reason that the buyer's assumption and payment of current liabilities of the business did not constitute initial payment in the year of sale under Section 453 (b) (2) (A) (ii) of the Internal Revenue Code of 1954.

STATUTE AND REGULATION INVOLVED

Internal Revenue Code of 1954:

SEC. 453. INSTALLMENT METHOD.

(a) Dealers in Personal Property. -- Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty. --

(1) General rule. -- Income from --

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation. -- Paragraph (1) shall apply --

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition --

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44(b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in Section 44(a)

of such code.

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.453-4 Sale of real property involving deferred periodic payments.

(a) In general. Sales of real property involving deferred payments include (1) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

(b) Classes of sales. Such sales, under either paragraph (a) (1) or (2) of this section, fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of real property which may be accounted for on the installment method, that is, sales of real property in which (i) there are no payments during the taxable year of the sale or (ii) the payments in such taxable year (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price, or

(2) Deferred-payment sales of real property in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

(c) Determination of "selling price". In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the "selling price"; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and sections 1.453-1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term "payments" does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price.

(26 C.F.R., Sec. 1.453-4.)

STATEMENT OF THE CASE

The appellant's statement of the case is not controverted. In 1959, plaintiffs sold the business and assets of their company to a corporation in which they were shareholders with two other persons. The sale was reported as an installment sale. The company's current liabilities were assumed and paid by the corporation in 1959 in the ordinary course of business. The Commissioner refused

to treat the sale as an installment sale on the grounds that the payments in the year of sale exceeded 30% of the selling price. A numerical summary of the respective positions of the taxpayers and the Commissioner of Internal Revenue is contained in Appendix A.

SUMMARY OF ARGUMENT

The assumption and payment of current liabilities by the buyer in the year of sale are not initial payments under Section 453(b) (2) (A) (ii). The undisputed gain of $20,287.39 will be and should be reported over the years as installments are received on the contract price of $84,944.36 to be paid by the buyer to seller. The appellees' position is consistent with the statute and regulations and is supported by (1) the underlying basis and reason for the installment sale provisions, (2) the rule applicable to secured liabilities set forth in the regulations as approved by the Supreme Court, (3) the rule in similar situations concerning the assumption of liabilities where stock is sold or real property is sold on a contract of sale, and (4) the analogous situation involving the assumption of liabilities under Sections 351 and 357 of the Internal Revenue Code. The appellant's reliance on the constructive receipt doctrine is not applicable or supported by the authorities cited. If the appellant's position is accepted, a distinction without merit, contrary to the purpose and plain meaning of the statute would result. The assumption of the seller's liabilities owing to third parties by the buyer should not constitute initial payment regardless of whether the liabilities are (1) paid in full or in part in the year of sale, (2) long-term or short-term, (3) secured or unsecured, or (4) pertain to real or personal property. The adoption of appellant's position would permit a variety of rules depending on a variety of factors that have no logic or

reason in determining the applicability of the installment sale provisions, and would cause unfair, inequitable and unintended results.

ARGUMENT

A. BASIS OF THE INSTALLMENT SALE PROVISIONS.

Section 453(b) of the Internal Revenue Code of 1954 provides for the installment method of reporting income from the casual sale of realty and personal property if the payments (exclusive of evidences of indebtedness of the purchaser) received during the taxable year of sale do not exceed thirty percent (30%) of the selling price. The District Court's decision upon a question heretofore undecided, in the construction of the above statute finds ample support in the basic reason for the installment sale provisions and the application of such provisions to analogous questions.

The installment sales provisions were enacted to relieve taxpayers who received only a small portion of the sale price in cash from paying full tax on the gain in the year of sale, thus allowing the gain to be spread over the period during which the taxpayer would receive the funds.[1] Burnet v. S. & L. Building Corporation, 288 U.S. 406 (1933); C.I.R. v. South Texas Lumber Company, 333 U.S. 496 (1948).

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1. "The installment basis of reporting was enacted, as shown by its history, to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had received in cash only a small portion of the sales price."
Commissioner v. South Texas Lumber Company, 333 U.S. 496, 503 (1948).

B. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE "MORTGAGE RULE"

In sales of mortgaged property, the amount of the mortgage is included in the "selling price" but in determining the "contract price" and payments in the year of sale, the amount of the mortgage is treated as "payment" only to the extent that it exceeds the basis of the property sold. (2) This insures that the entire profit is is reported over the years. United Pacific Corp., 39 T.C. 721, n.3 (1963). In Denco Lumber Co., 39 T.C. 8 (1962) Acq. 1963-28, 7, a first mortgage in favor of a third party lender which was assumed by the buyer was held not to be initial payment in the year of sale, despite the fact that the mortgage was placed upon the property immediately prior to sale, and the loan proceeds were received by the buyer. The mortgage rule applies with equal logic and purpose to current liabilities, whether such current liabilities are secured or unsecured. There is no real distinction between mortgages and other liabilities assumed by the purchaser; they all represent debts to third parties. Katherine H. Watson, 20 B.T.A. 270 (1930),

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2. U.S. Treasury Regulations, Sec. 1.453-4(c)
". . .

(c) Determination of 'selling price'. In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall, for the purpose of determining whether a sale is on the installment plan, be included as a part of the 'selling price'; and for the purpose of determining the payments and the total contract price as those terms are used in section 453, and Sections 1.453-1 through 1.453-7, the amount of such mortgage shall be included only to the extent that it exceeds the basis of the property. The term 'payments' does not include amounts received by the vendor in the year of sale from the disposition to a third person of notes given by the vendee as part of the purchase price which are due and payable in subsequent years. Commissions and other selling expenses paid or incurred by the vendor shall not reduce the amount of the payments, the total contract price, or the selling price. (Reg. Sec. 1.453-4.)"

Acq. X-1, C. B. 68 (1931).

The Supreme Court in Burnet, supra, recognized the practical difficulties inherent if mortgages were not excluded from the sale price in determining the contract price. (3) The same practical difficulties will be compounded because of the number of third-party creditors with different payment terms if current liabilities to such third persons are likewise not excluded in determining the contract price. Appellant's position as to current liabilities is precisely that which the Supreme Court rejected as to mortgages in Burnet. In arriving at that holding, the Supreme Court recognized the necessity of reporting the entire gain in an orderly manner as the taxpayer received the money over the years. To tax the entire gain in the year of sale when the taxpayer has little or no cash to pay the tax would work an inequity and foster administrative difficulties.

Though acknowledging the mortgage rule (Brief of Appellant, p. 19.), appellant inconsistently contends that the year in which the liabilities are actually paid is determinative. If appellant's contention is accepted, the applicability of the installment sale provisions would depend upon circumstances over which the seller-taxpayer has no control, namely, the time such liabilities are in fact paid by the buyer. Further, such seller would be burdened with ascertaining when such liabilities were paid from his buyer's records. Numerous payments on many different dates and during varying periods of time are likely to be involved. In the instant case, which involves numerous unsecured liabilities, it is impossible to determine

3. "The method suggested by the respondent would inevitably lead to many practical difficulties; might postpone collection far beyond the time when the vendor would receive any direct payments; and probably would render impossible determination from the taxpayer's books of what he should account for." Burnet v. S. & L. Building Corporation, 288 U.S. 406, 414 (1933).

from the taxpayer's books and records when such liabilities were paid by the buyer and the taxpayer may not be able to secure this information from the buyer.

The time that the buyer makes payment of the liabilities to third parties logically has no bearing on whether a taxpayer is entitled to use the installment sale method. If, for example, the transaction takes place on December 15 and the current liabilities are paid the following year or years, the taxpayer would be entitled to use the installment method. To deny use of such installment method in the instant case is to draw a distinction without a difference. If the appellant's argument is accepted, there would remain the question of transactions involving partial payment by the buyer in the year of sale of such liabilities. The question would then arise as to whether payment in subsequent years of these liabilities would be considered payments to the seller. If the appellant's argument that the payments in the year of sale on such liabilities are constructively received is valid, then it must follow that payments on such liabilities by the buyer in following years would be constructively received in those years. Appellant has not faced these questions. Under the mortgage rule, it makes no difference when the mortgage is actually paid, and a taxpayer is entitled to use the installment method even though the entire mortgage may be both payable and paid by the purchaser immediately after the sale. The regulations and authorities logically make no inquiry into the date a mortgage is payable or paid. Significantly, there are no statutes, no regulations and no decisions expressly precluding application of the well-established mortgage rule to current liabilities.

C. THE DISTRICT COURT'S DECISION IS SUPPORTED BY RULES APPLICABLE TO STOCK PURCHASES.

Where a purchaser of stock assumes the seller's unpaid balance owing on the shares, this assumption of liability is not treated as initial payment. I. T. 2468 VIII-1 C. B. 159 (1929). The ruling holds that the assumption by the purchaser of the unpaid balance due from the taxpayer is considered to be the same as that of the assumption of an existing mortgage in connection with a sale of property.

D. THE DISTRICT COURT'S DECISION IS SUPPORTED BY SIMILAR RULES APPLICABLE TO TAX-FREE EXCHANGES.

Tax-free exchanges under Section 351 of the Internal Revenue Code become taxable under Section 357 to the extent the liabilities exceed basis and no distinction is made depending on whether or not the liability is in the form of a mortgage. See N. F. Tester, 40 T. C. 273 (1963), Affd. 327 F. 2d 788 (7th Cir. 1964) where only open accounts payable are involved in a transfer of a going business to a controlled corporation and the Court treated them the same as secured liabilities under Section 357.

In Arthur L. Kniffen, 39 T. C. 553 (1962), the taxpayer transferred the assets and liabilities of his sole proprietorship to a corporation in exchange for 1, 000 shares of stock. After the exchange, the taxpayer held 1, 048 out of the 1, 050 shares issued and outstanding. The corporation assumed liabilities of approximately $294, 000 which exceeded the basis of the assets transferred of approximately $286, 000. Included in the liabilities of the taxpayer was an account payable in the amount of approximately $44, 000 in favor of the corporation which was assumed and

discharged in the transaction. The issue was whether the $44,000 in accounts payable assumed and discharged in the transaction was "other property or money" under Section 351(b) dealing with tax-free transfers to a controlled corporation. The Commissioner argued that the assumption and discharge was "other property or money", that Sections 351 and 357 would not be applicable and that a substantial gain would therefore result to the taxpayer. The Court held that the assumption and discharge was not "money or other property" for purpose of Sections 351 and 357 and that only the $8,000 of total liabilities in excess of basis would be realized gain. The questions presented to this Court is analogous. in Kniffen, the Court, holding that it does not matter when the liability is discharged by the transferee and to whom the liability is owed, said:

> "As we read sections 351 and 357 of the 1954 Code and section 112 (b) (5) and (k) of the 1939 Code, Congress, in employing the term "liability" in section 357(a) and section 112(k), was looking at the assumption by the transferee corporation of an existing liability of the transferor, not to the subsequent extinguishment of the debt, whether by payment, operation of law, or otherwise.
>
> Normally the liability accounts transferred pursuant to an exchange qualifying under section 351 will later be discharged in due course by the corporate transferee. But the fact of subsequent discharge and the time of discharge appear to be irrelevant in determining the applicability of

that section so long as the liabilities belong to the transferor at the time of the exchange and the purpose of the assumption is other than the avoidance of Federal income tax as described in section 357(b). Conceivably some of the "assumed" liability accounts may be discharged by the acquiring corporation on the same date the exchange was consummated. Others possibly might be defaulted and never discharged. But these facts do not appear to affect the applicability of sections 351 and 357 to an otherwise qualifying exchange.

Nor does it appear to be of critical importance to whom the liability is owed." (p. 561.) (Emphasis the court's.)

E. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULES APPLICABLE TO CONTRACTS OF SALE.

When a purchaser assumes a liability to which property is subject in a contract of sale, such assumption is not initial payment. J.W. McWilliams, 15 B.T.A. 329 (1929), Acq. VIII-2, C.B. 34 (1929). A land sale contract, while similar to a mortgage, legally is not a mortgage. Nevertheless, the Court applied the same rules and regulations to the contract as are applied to a mortgage. No payments were made by the purchaser to the third party creditor in the year of sale. Had any such payments been made, the Court would be forced to violate the mortgage rule to hold that such payments were initial payment in the year of sale.

F. THE DISTRICT COURT'S DECISION IS SUPPORTED BY THE RULE ESTABLISHED IN THE LIPMAN CASE.

In the Estate of Henry Lipman, et al., v. U.S., 65-2 U.S.T.C. 9579 (DCED Tenn. July 12, 1965) the wife in 1959 sold shares with a cost basis of $14,400 to a corporation in which her husband was the Treasurer and a Director for $54,000. The terms of sale provided for payments of $6,000 per year, starting in 1960, and as

part consideration, the parties agreed that the corporation might retire an $18,000 debt that her husband owed to the corporation by crediting $6,000 per year against the indebtedness commencing in 1965. Accordingly, she would receive approximately $35,000 in cash and the cancellation of her husband's indebtedness in the amount of $18,000. The Court held that neither Mr. or Mrs. Lipman received any payment in the year of sale, 1959, and accordingly, the installment sale method was permitted.

G. THE DOCTRINE OF CONSTRUCTIVE RECEIPT OF INCOME, RELIED UPON BY APPELLANT, IS INAPPLICABLE.

The appellant argues that the assumption and payment by the buyer in the year sale amounts to a constructive receipt of a payment in the year of sale. Appellant does not contend that the mere assumption without payment thereon in the year of sale should be treated as such a payment.

There is no question that the mere assumption of the liabilities in question is "consideration", part of the "selling price" and considered in computing the "gain" on the transaction. The question is whether or not such assumption and payment is part of the initial payment.

The facts here indicate no agreement as to when the buyer was to pay the liabilities. The facts do not indicate when the liabilities were due, or that the taxpayer had any control over the payment of them by the buyer corporation. There is nothing in the facts to indicate constructive receipt.

Section 451 of the Internal Revenue Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. Section 453 provides such a method, the installment sale method. The doctrine of constructive receipt of income is set forth in Regulations Section 1.451-2, which states that income, although not actually reduced to a taxpayer's

is credited to his account or set apart for him so that he may draw upon it at any time.[4] No amounts were credited or set aside for the taxpayer in the instant case since the liabilities were payable to third parties. There is nothing in the facts to indicate what persons had the responsibility of paying the bills of the purchaser corporation. Clearly the doctrine of constructive receipt has no application to the case in question.

The Tax Court has frequently stated that the doctrine of constructive receipt is to be "sparingly applied", and that the doctrine would be invoked only in "unique circumstances and a clear case". Pedro Sanchez, 6 T.C. 1141, 1148 (1946) affirmed 162 Fed. 2d 58 (2nd Cir. 1947).

Cash is not constructively received by a seller when it is placed in escrow if the cash is not unqualifiedly subject to the demand of the seller. Harold W. Johnston, 14 T.C. 560 (1950). A seller was entitled to use the installment method where 75% of the sale proceeds were deposited in escrow to be released over a period of five years to the seller. The receipt of these funds by the escrow holder did not constitute constructive receipt. Rebecca J. Murray, 28 B.T.A. 624 (1933).

If appellant's argument of assumption and constructive receipt were consistently applied, it would be equally applicable in the case of a liability secured by a mortgage and such position would then be contrary to the Regulations and authorities

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4. "Constructive receipt of income. -- (a) General Rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions." U.S. Treasury Regulations, Sec. 1.451-2(a)

cited.

H. ANALYSIS OF AUTHORITIES RELIED UPON BY APPELLANT

The appellant argues that McWilliams v. Commissioner, 15 B. T. A. 329 (1929) cited by the District Court, is not authority for its decision. (Brief of Appellant, p. 21.) The court held that the assumption of the contractual liability on the land was similar to a purchase money mortgage and should be treated the same way, and, accordingly, that the purchase price included the $130,000 unpaid on the contract at the time of sale by the taxpayer. The court did not hold that this $130,000 was part of the initial payment; had the $130,000 been considered initial payment, the installment method would not have been available. The quotation from McWilliams in the appellant's brief (p. 22) sets forth the reasoning of the court that the assumption of the land contract should be considered the same as a mortgage.

Revenue Ruling 60-52, 1960-1 CB 186, (Brief of Appellant, p. 27.) is concerned with a similar but narrower problem common in the sale of real property not encountered herein. Such expenses are usually paid at the time of sale and are often paid immediately through escrow. In this connection, the language of the Court in Katherine H. Watson, 20 B. T. A. 270, 272 (1930) should be noted:

> "No brief has been filed on behalf of the respondent and we are not informed of his reason for including as a part of the initial payment the amount of the prorated charges assumed by the purchaser in the face of his regulations excluding therefrom the amount of the mortgages. The evidence is clear that the prorated charges were not paid by the purchaser within the

taxable year. From a practical standpoint there is no real distinction between the two forms of indebtedness assumed by the purchaser. All of the items represented debts of the petitioners to third parties, and, like the mortgages assumed were liens against the land sold. The sum of $24,017.50 being less than 25 per cent of the selling price of the property, petitioners are entitled to return the sale on the installment basis."

It is clear from the above that the Court felt there was no difference between secured and unsecured liabilities and it is certainly not clear that had such payments been made in the year of sale that they would have been included as initial payment by the court. We submit that the reason for the holding that accrued interest and taxes assumed by the buyer, though includable in the purchase price, were not part of the initial payment is not because there was no evidence that the buyer paid these items in the year of sale but rather that the court wished to treat the unsecured liabilities of the seller in the same manner as the assumption of a mortgage.

A seller has been permitted to return part of the initial payment to the buyer where he received in excess of 30 per cent through a mutual mistake and thereby report the sale on the installment method. Ludlow v. C.I.R., 36 T.C. 102 (1961).

The assets of the business sold by appellees are subject to the liabilities where no notice is recorded and published under the Bulk Sales Law. (California Civil Code, Section 3440.1, now California Commercial Code Sections 6101 et seq.) The purchaser obtains title to the assets subject to the claim of the creditors, 23

Cal. Jur. 2d 527; Abbey v. Zimmerman, 12 Cal. App. 2d 311 (1936).

Appellant relies on Smith v. Commissioner, 324 Fed. 2d 725 (9th Cir. 1964) for the proposition that the "amount realized", "selling price" and "total contract price" include the liabilities of the seller assumed by the purchaser. (Brief of Appellant, p. 15.) The Smith case was not an installment sale case. It involved the question of whether or not a sale took place in 1956 or 1957, and, secondly, if the sale was a 1956 sale whether all of the gain was taxable in 1956, which depended upon the valuation of the sale contract. The taxpayer argued that the sale contract could not be valued and, accordingly, the gain should not be realized in 1956. The Tax Court held that it was not necessary to value the contract and said that the agreement to discharge personal obligations of the seller is the same as receiving cash. The Ninth Circuit properly held that the assumption of these personal obligations may be treated as "money received" under Sec. 1001(b) of the Internal Revenue Code of 1954 for purposes of determining the amount of gain. If one were to take the statement at face value that the agreement to discharge the personal obligations of the seller is tantamount to receiving cash, then this statement would be equally applicable in the case of mortgages or secured obligations, long or short term obligations, and would be clearly contrary to the mortgage rule set forth in the Regulations. In Burnet, supra, the court and the Commissioner held the "total contract price" to be the amount payable directly to the vendor.

All of the cases cited by the Ninth Circuit in Smith, as set forth by appellant (Brief of Appellant, pp. 16-17.) properly hold that the mortgages involved in each case are part of the amount realized and must be taken into consideration

in computing the gain. Appellee has no argument with these cases. None are installment sales cases, and none involve the question of initial payments in the year of sale. If these cases were decided otherwise, gain realized would escape taxation completely.

For example, the R. O'Dell & Sons Co. v. Commissioner, 169 Fed. 2d 247 (3rd Cir. 1948) and Mendham Corporation v. Commissioner, 9 T. C. 320 (1947) cases simply hold that the discharge of a mortgage in excess of basis results in taxable gain.

None of the cases cited by the appellant on page 17 of its brief for the proposition that payment of the seller's liability represents constructive receipt are installment sale cases. In fact, only a few of these cases make any reference to "constructive receipt" in the opinions. These cases merely hold, and rightly so, that when another party to a transaction discharges an obligation of a taxpayer that the taxpayer thereby realizes income.

For example, in Sowell v. Commissioner, 302 Fed. 2d 177 (5th Cir. 1962) the court held that oil and gas income is constructively received when the income therefrom is applied in payment of debts for which the taxpayer's economic interest is liable. Interestingly enough, the court refers to this as a "man bites dog case" where the taxpayer argued that he had received income; the Commissioner argued that there was no constructive receipt of income. The case properly stands for the principle that application of the taxpayer's own income from his property in discharge of his debts is the realization of income by the taxpayer.

In Diescher v. Commissioner, 36 B. T. A. 732 (1937) the court merely held that a principal realizes taxable income when his agent receives money and does not

remit that income to the principal.

Tombari v. Commissioner, 299 Fed. 2d 889 (9th Cir. 1962), (Brief of Appellant, p. 18.) is not in point. The issue was whether or not a contract owned by the buyer and assigned to the seller as part of the purchase price for the sale of a pharmacy should be valued at face value or market value in computing the sale price upon which the 30% payment in the year of sale rule is based. The court held that the face value of the chose in action received by the seller is the proper amount to include in the sale price.

Corona Flushing Co. v. Commissioner, 22 B. T. A. 1344 (1931) (Brief of Appellant, p. 21.) does not hold that assumed liabilities paid in the year of sale by the buyer are payments received in the year of sale. In that case the taxpayer sold real property for a purchase price of $32,000 made up as follows: $3,000 cash upon signing of the contract; $8,960 by assumption of a first mortgage; $15,000 in the form of a purchase money second mortgage; and $5,040 in cash on delivery of the deed at the closing of title. The seller was obligated in the transaction to pay $458.52 for prorate of taxes and interest and this amount was paid by the taxpayer to the purchaser on the closing of title. The taxpayer argued that he had not received the $5,040 at closing but rather the net amount of $4,581.48. The court held that since he had actually received the $5,040 it must be considered part of the initial payment. The court said, "If the items, aggregating $458.52, were in fact assumed by the purchaser there might be some ground for excluding these items from the initial payments, as we did in Katherine H. Watson et al., . . . " 22 B. T. A. 1344, 1346. The court further said: "All of these items, totaling $458.52, were liabilities which the petitioner had to discharge before it could

convey the property free of encumbrances." 22 B. T. A. 1344, 1347.

The appellant argues that there would be no difference from a tax standpoint if the purchaser had paid the $25,568.86 directly to the taxpayers (appellees) and they had used the proceeds to pay the accounts payable. We concede that had the taxpayers actually received $25,568.86 in cash from the purchaser in the year of sale with no assumption by the buyer that this would be considered initial payment. This did not take place. However, as quoted in Corona Flushing Co. ". . . It seems to us to be fundamentally unsound to determine income tax liability by what might have taken place rather than what actually occurred. Even though the practical effect may be the same in either case, the resulting tax liability may be quite different. United States v. Isham, 17 Wall 496, . . . " 22 B. T. A. 1344, 1347.

The holding in Wagegro Corp., 38 B. T. A. 1225 (1938) (Brief of Appellant, p. 21.) that the payment by the buyer of $750 of legal fees incurred by the seller's attorney in preparing the necessary papers was part of the consideration and initial payment in the year of sale should not be controlling in this case. In the first place, the liability in question was not a pre-existing obligation of the seller which was assumed by the buyer. Secondly, it was one item that both parties knew had been paid and was not fraught with all of the problems apparent in a holding contrary to that of the District Court in this case. Furthermore, it is interesting to note that the Commissioner argued that the $750 of legal fees was not a part of the purchase price received in the year of sale. The Court, in holding that the legal fee was part of the initial payment, thereby permitted the taxpayer to use the installment basis under the law in existence at that time, which apparently required some down payment in the year of sale.

Caldwell v. United States, 114 Fed. 2d 995 (3rd Cir. 1940) (Brief of Appellant, p. 25.) simply holds that a chose in action owing to the buyer and given to the seller as part of the sale price is other property and therefore part of the initial payment. In that case the buyer caused a third party holding company to pay cash and issue obligations to the seller and the court held that the obligations of the holding company were not obligations of the buyer and therefore could not be considered evidences of indebtedness of the buyer.

Freeman v. Commissioner, 303 F. 2d 580 (8th Cir. 1962) cited by the appellant (Brief of Appellant, p. 25.) is also not in point and merely holds that the note of a third party received by the seller is other property and is not an obligation of the purchaser. These cases have nothing whatsoever to do with the assumption by the purchaser of an indebtedness of the seller.

CONCLUSION

The District Court did not err in deciding that the assumption and payment by the purchaser of the current liabilities of the plaintiffs-sellers' business did not constitute "payments actually received in that year" of sale under section 453 of the Internal Revenue Code of 1954, and that the plaintiffs are entitled to report such sale on the installment method. The District Court's decision is consistent with the statute and regulations, and is supported by: (1) the underlying basis and reason for the installment sale provisions, (2) the rule applicable to secured liabilities set forth in the regulations as approved by the Supreme Court, (3) the rule in similar situations concerning the assumption of liabilities where stock is sold or real property is sold on a contract of sale, and (4) the analogous situation involved in the assumption of liabilities under sections 351 and 357 of the Internal Revenue Code.

Respectfully submitted,

DRISCOLL, HARMSEN & WILKINS,

By: HARLAN F. HARMSEN and

/s/ JOHN GERALD DRISCOLL, JR.

Attorneys for Appellees

APPENDIX A

APPENDIX A

NUMERICAL SUMMARY OF THE RESPECTIVE POSITION OF THE TAXPAYERS AND THE COMMISSIONER OF INTERNAL REVENUE

	Taxpayer	Commissioner of Internal Revenue
Sale Price:		
Corporate installment note	$ 75,000.00	$ 75,000.00
Assumption of Marshall note by corporation	9,944.36	9,944.36
Assumption of current liabilities by corporation	25,568.86	25,568.86
Total selling price	110,513.22	110,513.22
Less Adjusted Basis of Business and Assets Sold	90,225.83	90,225.83
Long-Term Capital Gain	$ 20,287.39	$ 20,287.39
Payments Received in Year of Sale, 1959:		
Marshall note paid	$ 9,944.36	$ 9,944.36
Cash payment on corporate installment note	4,000.00	4,000.00
Assumption and Payment of Current Liabilities by Corporation	-0-	25,568.86
Total Payments in Year of Sale - Initial Payment	$ 13,944.36	$ 39,513.22
30% of Selling Price of $110,513.22	$ 33,153.97	$ 33,153.97
Contract Price:		
Selling Price	$110,513.22	$110,513.22
Less Current Liabilities assumed and paid	25,568.86	-0-
Contract Price	$ 89,944.36	$110,513.22

			Taxpayer	Commissioner of Internal Revenue
Profit Percentage:				
Taxpayer	$\frac{20,287.39}{84,944.36}$	=	23.883%	
Commissioner	$\frac{20,287.39}{110,513.22}$	=		18.357%
Gain Taxable in 1959:				
Taxpayer	23.883% of $13,944.36	or	$ 3,330.33	
Commissioner	18.357% of 110,513.22	or		$ 20,287.39

CERTIFICATE

I certify that, in connection with the preparation of thie brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: October 15, 1965.

/s/ JOHN GERALD DRISCOLL, JR.

Attorney for Appellee